



THE NCLT'S DISCRETION U/S 7 OF THE IBC IN VIDARBHA INDUSTRIES POWERS LIMITED VS. AXIS BANK LIMITED (2022): A CASE COMMENT

Teesha Sharma*

INTRODUCTION

Insolvency and Bankruptcy Code of 2016 primarily focuses on rehabilitating sick financial companies who are unable to pay dues in time rather than dissolving the company. The idea behind the same is to reserve the resources used in establishing a company that can be back on its feet once helped. Earlier enactments such as the Sick Industries Companies (Special Provisions) Act, 1985 and the Companies Act, 1956 failed to reconstruct the company during the winding up of the company. Therefore, the latest Insolvency and Bankruptcy Code is deemed to be the most effective code in modern India to reconstruct a sick company. Moreover, it is an established law that once the default by the corporate debtor for not paying the dues to the financial creditor in time is established, the NCLT is bound to accept the application for initiation of CIRP, that is Corporate Insolvency Resolution Process U/s 7 of the IBC Code, 2016. In the present case of Vidarbha Industries Powers Limited v Axis Bank Limited¹, the court held the opposite. It is a landmark judgement in Indian Judicial history wherein the application for initiation of the CIRP process under section 7 was rejected even when the default of dues was established. Administrative decision-making is difficult to categorize due to its diverse nature. It should be noted at the outset that administrative tribunals are established under Articles 323-A and 323-B of the Indian Constitution. From a functional standpoint, an administrative tribunal falls midway between a judicial and an administrative body. However, an administrative tribunal must have the following features². Firstly, an administrative tribunal is the creation of a statute, hence it has statutory roots. Second, it possesses certain aspects of a court, but not all. Third, an administrative tribunal is endowed with a state's judicial powers and, as such, conducts judicial and quasi-judicial responsibilities as opposed to pure

*BLS LLB, FOURTH YEAR, SVKM'S PRAVIN GANDHI COLLEGE OF LAW.

¹ Vidarbha Industries Powers Limited v Axis Bank Limited MANU/SC/0874/2022

² "Frank's Report", 1987 Cmnd 218, para. 40 quoted in C.K. Thakker, Administrative Law (Eastern Book Company 1992) 231

administrative or executive functions, and is obligated to exercise judicial authority. Fourthly, most tribunal rulings are judicial rather than administrative in the sense that they must record objective factual findings and then apply legislation to them without respect for executive policy. They are granted discretion, but it must be utilized objectively and judicially. Fifthly, administrative tribunals are autonomous, and they are not subject to administrative influence in carrying out their judicial or quasi-judicial powers. Sixthly, Administrative tribunal decisions can be challenged using the prerogative writs of certiorari and prohibition.

FACTS OF THE CASE

Axis Bank, as a financial creditor, filed a petition under Section 7(2) of the Insolvency and Bankruptcy Code (IBC) with the NCLT in Mumbai to initiate the Corporate Insolvency Resolution Process (CIRP) against Vidarbha Industries. In response, Vidarbha Industries requested a stay on these proceedings through Miscellaneous Application No. 570 of 2020 in C.P. (IB) No. 264 of 2020, citing the pending Supreme Court appeal (Civil Appeal No. 372 of 2017) related to its financial disputes.

Vidarbha Industries, a power producer operating a 600 MW coal-fired thermal plant in Maharashtra, has been supplying power to Reliance Infrastructure Ltd. (RIL) since April 1, 2014. The company faced financial strain after the Maharashtra Electricity Regulatory Commission (MERC) and later the Appellate Tribunal for Electricity (APTEL) made decisions regarding fuel cost adjustments and tariff caps. Despite APTEL's favorable ruling, which claimed that INR 1,730 Crores was owed to Vidarbha Industries, MERC's appeal against this ruling was still pending in the Supreme Court. Vidarbha argued that the financial stress due to the pending appeal hindered its ability to settle debts, leading to Axis Bank's petition for CIRP. The NCLT and NCLAT both rejected Vidarbha's request for a stay, asserting that Section 7 admission is mandatory once debt and default are established. This issue was then brought before the Supreme Court to determine whether Section 7(5)(a) is mandatory or discretionary.

LEGAL ISSUE

Whether the Adjudicating Authority (NCLT) has discretionary power under Section 7 of the Act to accept or reject an application wherein default is established.

CONTENTIONS

From the Appellant's side

The lack of liquidity as argued by the Vidarbha Industries stems entirely from the pending appeal before the Supreme Court filed by MERC. The company argued that the application should have been denied due to the unique nature of its business, where tariff determinations are made by MERC and APTEL. Furthermore, Section 7(5)(a) of the IBC provides discretionary power to the Adjudicating Authority using the term 'may' rather than 'shall', indicating that acceptance of an application is not mandatory. The purpose of the IBC is to revive the company and maximize asset value, so a rejection in line with this objective would also be appropriate. The Act's primary aim is to revive rather than liquidate the company.

Vidarbha Industries argued that its debt is solely due to the pending appeal, which if resolved favorably, would allow it to collect INR 1,730 Crores and settle the debt. One of the most strong and main arguments was wherein Vidarbha Industries contended that Section 7(5)(a) of the IBC uses the term 'may' regarding the initiation of CIRP, suggesting that the NCLT has the discretion to reject an application even with a debt present if it serves the purpose of justice and the IBC's goal of company revival and asset value maximization.

From the Respondent's side

Axis Bank Ltd. argued that under the statute, once a default in payment is confirmed, the application must be approved. Citing the *Swiss Ribbons Pvt. Ltd. v Union of India* case, Axis Bank emphasized that the IBC's legislative intent shifted from assessing "inability to pay debts" to simply confirming a "default." They pointed out that Section 7 requires the adjudicating authority to verify the existence of default within 14 days of receiving the application, and if default is confirmed, the application should be accepted. Axis Bank concluded that Section 7 is mandatory, noting that despite the application being filed over a year ago, Vidarbha Industries' financial condition had not improved.

Axis Bank contended that since the appellant is in acknowledged default, the NCLT appropriately refused to stay the proceedings under Section 7(5). The *Swiss Ribbons* case affirmed that a financial creditor's application is triggered by the non-payment of dues. Therefore, once a default is proven, the Adjudicating Authority must accept the application as

the Act does not grant discretionary powers for rejection. The IBC aims to provide a prompt legal process for insolvency resolution, a point reinforced by the Innovative Industries case.

COURT'S OBSERVATION

The Supreme Court ruled that both earlier fora, in accordance with Section 7 of the IBC, had simply examined whether a debt and requisite default had occurred. It was determined that neither organization had considered the merits of the case. While not agreeing with the earlier forums, the Supreme Court ruled that the ATEPL award cannot be fully ignored, and Vidarbha Industries' viability and general financial health cannot be dismissed as irrelevant. While holding that the word "may" in Section 7(5) is directory, the Supreme Court ruled that the rule of literal construction must be considered when interpreting statutes.

The Supreme Court also defined the distinction between CIRP Proceedings filed by an Operational Creditor and Financial Creditors. While the former, under Section 9(5), "shall" be allowed to initiate CIRP upon the existence of debt and default, the latter "may" be permitted to do so if the tribunal is satisfied that no other reasons preclude the application from being allowed, as was seen in the present case. Due to these reasons, the Orders passed by the NCLT and NCLAT were set aside by the Supreme Court, holding Section 7(5)(a) to be directory and allowing the tribunals to pass the application based on facts and circumstances other than the presence of debt and default of the

ANALYSIS

An important argument presented by the counsel of the company, Vidarbha Industries Power Limited, is that: *"The Adjudicating Authority (NCLT) was required to apply its mind to relevant factors including the feasibility of initiation of CIRP, against an electricity generating company operated under statutory control, the impact of MERC's appeal, pending in this Court, order of APTEL referred to above and the overall financial health and viability of the Corporate Debtor under its existing management."* Herein, the counsel evidently made an attempt to realize the court that the company against which an application is filed is under "statutory control" and that is an indication of possible creation of personal biases in such instances. It is indeed not the highlighted fact of the case and is not reiterated but it is an essential point that raises eyebrows for the Adjudicating Authority³ to take a discretionary action to not initiate CIRP

³ Section 3 (2) "bench" means a bench of the Adjudicating Authority of the IBC, 2016

proceedings even when a clear debt is established. It is pertinent to mention that whenever such discretionary powers are confined within statutory authorities, the same comes while keeping the following factors in mind:

1. Principles of Natural justice

In the case of *Maneka Gandhi V Union of India*⁴, Bhagwati, J. clarified that previous administrative inquiries are now considered quasi-judicial. Administrative and quasi-judicial inquiries strive to reach a just result. The standards of natural justice aim to prevent miscarriages of justice, thus it's unclear why they should not apply to administrative inquiries. Listening to the opposing viewpoint is a fair norm, as discussed above. The Constitution emphasizes the need for fairness as part of the rule of law. Natural justice is a statutory requirement, and any action that violates it is considered unjust and hence unacceptable. The two fundamental principles of Natural Justice are: 1. *Nemo Judex in Causa Sua*: (a) Rule against bias and *Audi Alter m Partem* (a) Hear the other side. (b) Hear both sides. (c) No person should be condemned unheard. Herein this case, the principle of personal bias is of importance. The rule against bias is crucial. In the context of the present case, the NCLT's discretionary power, the tribunal must ensure that its decision-making process is impartial and considers all relevant factors, including the unique financial situation of the debtor.

2. The Doctrine of Legitimate Expectation

The doctrine of legitimate expectation is also a fine example of judicial creativity. Nevertheless, it is not extra-legal and extra-constitutional. A natural habitat for this doctrine can be found in Article of the Constitution, which abhors arbitrariness and insists on fairness in all administrative dealings. It is now firmly established that the protection of Article 14 is available not only in case of arbitrary "class legislation", but also in case of arbitrary "State action". Thus, the doctrine is being hailed as a fine principle of administrative jurisprudence for reconciling power with liberty. The doctrine of legitimate expectation operates to ensure fairness and predictability in administrative decisions. It protects the expectations of parties who have a reasonable anticipation of a certain outcome based on past conduct or representations made by administrative authorities. In this case, Vidarbha Industries had a legitimate expectation that its financial distress, influenced by ongoing litigation and regulatory

⁴ *Maneka Gandhi vs Union of India* AIR 1978 SC 597

decisions, would be factored into the NCLT's decision-making process. The Court's recognition of the NCLT's discretionary power under Section 7(5)(a) aligns with this doctrine, allowing for consideration of exceptional circumstances that affect the company's ability to repay its debts.

CONCLUSION

The observations in the Vidarbha judgment will open floodgates for resistance against the initiation of CIRP for corporate debtors, significantly affecting the functioning of the IBC. Nonetheless, the authors believe that such discretion is crucial to prevent the misuse of the IBC. The Supreme Court has granted the NCLT the authority to consider defenses raised by the corporate debtor but has not mandated that such defenses be accepted in every instance. It is important to highlight that the Code's purpose is not to subject a financially healthy and viable corporate debtor to the insolvency resolution process as a punitive measure. Although the review petition against the Vidarbha judgment was rejected, the case has faced strong criticism from both professionals and academics. The Indian government is planning to amend Section 7 of the Insolvency and Bankruptcy Code (IBC) to address ambiguities arising from judicial interpretations. This initiative follows the Supreme Court's decision in *Vidarbha Industries Power Limited v. Axis Bank Limited* (Civil Appeal No. 4633 of 2021), where the Court interpreted the term "may" in Section 7(5) to grant Adjudicating Authorities (AAs) the discretion to admit or reject insolvency applications, even when a default exists. This interpretation has led AAs to consider factors such as the solvency and financial health of corporate debtors during the admission stage, which was not the original intent of the law. Consequently, there is market confusion regarding the extent of AA's discretion at this stage. To eliminate these uncertainties, the government proposes amending Section 7 to clarify that, when financial creditors apply to initiate the Corporate Insolvency Resolution Process (CIRP), AAs should focus solely on verifying the occurrence of a default and ensuring procedural requirements are met. If a default is established, the AA would be mandated to admit the application and commence the CIRP. Additionally, the current 14-day timeline in Section 7 has been interpreted to apply only to the determination of default. The government intends to amend this provision to explicitly state that the 14-day period also encompasses the AA's decision to admit or reject the application under Section 7(5). These proposed amendments aim to streamline the insolvency resolution process, reduce ambiguities, and ensure that AAs

adhere to strict timelines, thereby enhancing the efficiency and predictability of the IBC framework.⁵

⁵ Rajan Jain, Invitation of comments from the public on changes being considered to the Insolvency and Bankruptcy Code, 2016, Government of India Ministry of Corporate Affairs (Jan. 18, 2023) <https://www.mca.gov.in/content/dam/mca/pdf/IBC-2016-20230118.pdf>